

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 07-0126
Income Tax
For Tax Year 2002**

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ISSUES

I. Adjusted Gross Income Tax—Apportionment Calculation.

Authority: IC § 6-3-2-2; IC § 6-8.1-5-1.

Taxpayer protests the calculation of the sales factor for the apportionment formula for adjusted gross income tax.

II. Tax Administration—Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer protests the imposition of a ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an out-of-state business doing business in Indiana. As the result of an audit, the Indiana Department of Revenue ("Department") issued a proposed assessment for adjusted gross income tax for the tax year 2002. The Department made various adjustments to Taxpayer's adjusted gross income tax return. Taxpayer protests the Department's adjustment to its sales factor numerator for adjusted gross income tax calculations. Taxpayer therefore protests the portion of the assessment related to the sales factor numerator adjustment and protests the imposition of penalty. Further facts will be supplied as required.

I. Adjusted Gross Income Tax—Apportionment Calculation.

DISCUSSION

Taxpayer protests the Department's recalculation of the sales factor in the apportionment formula for adjusted gross income tax for the year 2002. The Department determined that Taxpayer had reported a higher amount of sales to Indiana on its sales tax returns than the amount of sales it reported to Indiana on its adjusted gross income tax return. After determining that the two numbers did not match, the Department adjusted the sales factor numerator to the higher amount reported on the sales tax returns.

The sales factor is combined with the payroll factor and the property factor to arrive at an apportionment factor to determine the amount of a taxpayer's income which is subject to Indiana adjusted gross income tax, as established by IC § 6-3-2-2(b). The sales factor is explained by IC § 6-3-2-2(e), which states in relevant part:

The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the taxable year, and the denominator of which is the total sales of the taxpayer everywhere during the taxable year.

....

The Department determined that the numerator of the sales factor should be adjusted to reflect the higher reported amount on the sales tax returns. This adjustment resulted in a larger sales factor percentage, which in turn resulted in a higher apportionment percentage. The higher apportionment percentage resulted in an assessment for additional adjusted gross income tax for the year 2002.

Taxpayer protests that the Department only adjusted the numerator of the sales factor, without adjusting the denominator. Taxpayer argues that, with the Department's adjustments, the numerator uses figures from the sales tax returns, while the denominator uses figures from the adjusted gross income tax return, and that using these two different sources results in an incorrect sales factor calculation. Taxpayer points out that if the numerator and denominator both use figures from the sales tax returns, or if the numerator and denominator both use figures from the income tax return, the result is a 3.06 percent sales factor.

The Department's adjustment was to the sales factor numerator. The change in the numerator resulted in a higher sales factor percentage. This higher sales factor percentage was used in recalculating the apportionment percentage, which was higher as a result. The Department did not adjust the base amount of income subject to the apportionment percentage.

If the Department did not agree with the figures reported on the adjusted gross income tax return, then that concern would logically affect the figures used for both the numerator and the denominator. Since the Department accepted the figures used in the sales tax returns for the numerator, the Department should use those figures for the denominator as well. To mix and match figures from one return with another return, as was done here, results in a distortion of the calculation method.

The Department is permitted to use the best information available to determine Taxpayer's total Indiana sales figures, as provided by IC § 6-8.1-5-1(b). However, if the Department determines that one set of figures is the best information available to determine Indiana sales for the sales factor numerator, then the same best information should be used to determine everywhere sales for the sales factor denominator. Since the result of using the numbers from either return is the same 3.06 sales factor percentage, it is irrelevant which return is used. Taxpayer has met the burden imposed by IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is sustained.

II. Tax Administration—Negligence Penalty.

DISCUSSION

The Department issued proposed assessments and the ten percent negligence penalty for the tax year in question. Taxpayer protests the imposition of penalty. The Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part:

If a person:

...

(3) incurs, upon examination by the department, a deficiency that is due to negligence;

...

the person is subject to a penalty.

The Department refers to 45 IAC 15-11-2(b), which states:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

45 IAC 15-11-2(c) provides in pertinent part:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, Taxpayer has satisfactorily explained its filing methods. Taxpayer has affirmatively established that it exercised ordinary business care, as required by 45 IAC 15-11-2(c).

FINDING

Taxpayer's protest is sustained.